

VZCZCXRO9928
PP RUEHCN RUEHGH RUEHVC
DE RUEHIN #2545/01 3340757
ZNY CCCCC ZZH
P 300757Z NOV 07
FM AIT TAIPEI
TO RUEHC/SECSTATE WASHDC PRIORITY 7475
INFO RUEHOO/CHINA POSTS COLLECTIVE
RUEHBK/AMEMBASSY BANGKOK 3894
RUEHBY/AMEMBASSY CANBERRA 4649
RUEHML/AMEMBASSY MANILA 0200
RUEHGP/AMEMBASSY SINGAPORE 7064
RUEHKO/AMEMBASSY TOKYO 9278
RUEHWL/AMEMBASSY WELLINGTON 1915
RUEHCHI/AMCONSUL CHIANG MAI 0329
RUEHHM/AMCONSUL HO CHI MINH CITY 0157
RHEFDIA/DIA WASHINGTON DC
RUEATRS/DEPT OF TREASURY WASHDC
RUCPDOG/DEPT OF COMMERCE WASHDC
RUEAIIA/CIA WASHDC

C O N F I D E N T I A L SECTION 01 OF 04 TAIPEI 002545

SIPDIS

SIPDIS

STATE PASS USTR, STATE FOR EAP/TC, USTR FOR STRATFORD AND
KATZ, TREASURY FOR OASIA/TTYANG, COMMERCE FOR
4431/ITA/MAC/AP/OPB/TAIWAN

E.O. 12958: DECL: 11/29/2017

TAGS: [ECON](#) [EFIN](#) [ETRD](#) [PREL](#) [PGOV](#) [TW](#)

SUBJECT: HOW STRONG IS TAIWAN'S ECONOMY?

REF: A. TAIPEI 2505
[1](#)B. TAIPEI 2193
[1](#)C. TAIPEI 2283
[1](#)D. TAIPEI 2295
[1](#)E. TAIPEI 2336
[1](#)F. TAIPEI 2444
[1](#)G. TAIPEI 2525
[1](#)H. TAIPEI 2471
[1](#)I. TAIPEI 2531

TAIPEI 00002545 001.2 OF 004

Classified By: Stephen M. Young, AIT Director, for reasons 1.4 (b) and (d).

[1](#)1. (C) SUMMARY. Reflecting popular concern about the economy, both presidential candidates are raising economic issues as Taiwan heads into the 2008 legislative and presidential elections. The DPP boasts about Taiwan's solid growth even as the KMT pledges to reverse a purported economic decline. Taiwan's ambiguous performance lends itself to multiple interpretations: 2007 GDP growth has been revised upward to a respectable 5.46 percent, unemployment is under 4 percent, exports are booming, foreign direct investment is streaming in (ref a) and the stock market is up by six percent thus far this year. These positive figures, however, mask widely-held concerns about stagnating living standards and eroding international competitiveness. Taiwan's vibrant technology sector accounts for most export growth, but an uncompetitive service sector isn't always compensating for manufacturing job loss to the PRC and other low-cost countries. Although Taiwan remains an enormously successful economy, large portions of the public and the business community see its recent performance as unable to sustain a broad rise in living standards while allowing Taiwan to keep pace with regional competitors. There are important implications for the U.S.: An emphasis on competitiveness will accelerate cross-Strait integration and regulatory reform, likely improving the investment climate for U.S. firms. At the same time, ongoing concern about economic performance will fuel Taiwan's continued interest in a bilateral FTA and other tangible signs of U.S. commitment to Taiwan's continued

economic viability. END SUMMARY.

IT'S NOT JUST ABOUT CROSS-STRAIT ECONOMIC TIES

12. (C) Despite differences in emphasis, presidential candidates Ma Ying-jeou and Frank Hsieh share a relatively pragmatic approach to cross-strait integration, and both have declared their intentions to establish direct transportation links while liberalizing investment and tourism (refs b-e). This relative KMT-DPP convergence on cross-strait economic policy is based in part on a growing consensus that Taiwan is not positioning itself to take full advantage of China's ongoing economic boom. With both sides of the political aisle acknowledging the link between a more pragmatic cross-strait economic policy and Taiwan's economic strength, therefore, the cross-strait issue is merely one manifestation of an underlying concern with overall economic competitiveness.

AN ECONOMY IN TRANSITION

13. (SBU) Based on stronger-than-expected growth in exports, as well as a tentative rebound in private consumption, Taiwan's official 2007 GDP growth projection was recently revised upward by about a full percentage point, to 5.46 percent. David Hong, President of the private Taiwan Institute of Economic Research (TIER) think tank, told us that Taiwan's recent and projected annual growth rates in the 4-5 percent range are significantly lower than the economy's 50-year average of 8.2 percent after 1949, but are reasonable given Taiwan's level of development. Citing a joint analysis prepared by TIER and four other think tanks, Hong estimated Taiwan's potential annual growth rate at 5 percent. Although 5.46 percent GDP growth compares favorably with 2007

TAIPEI 00002545 002.2 OF 004

projections for Singapore, South Korea, and Hong Kong - the other three East Asian "tiger" economies - Taiwan's overall performance has been relatively weak in recent years. Since 2000, Taiwan's annual GDP growth has averaged 4.5 percent, versus 4.9 percent in Singapore, 5.2 percent in South Korea, and 5.5 percent in Hong Kong. Hong believes Taiwan is in the midst of an "industrial structuring transition" as the economy shifts from reliance on original equipment manufacturing (OEM) to an emphasis on original design manufacturing (ODM). In his view, Taiwan must adopt a new business model that includes more attention to branding, distribution, financing, and an increased focus on higher value-added manufacturing.

A BIFURCATED ECONOMY?

14. (SBU) Some private analysts have expressed concern that Taiwan is becoming a bifurcated economy, divided between a world class technology industry and a lackluster service sector. Based on 2006 data, Taiwan's technology sector dominated global production in a variety of key fields, including 66.7 percent of semiconductor OEM, 91.4 percent of Mask ROM production, 75.2 percent of TN/STN LCD panel production, and 60.3 percent of IC testing. Between 1986 and 2006, the technology sector's share of GDP rose from 9 percent to 13.3 percent, and technology's share of overall manufacturing production rose from 24 percent to 59 percent over the same period. As of last year, the technology sector accounted for half of manufacturing employment and 71.2 percent of total exports. Taiwan's economy, therefore, is inextricably linked to the island's successful technology sector.

15. (SBU) Is the technology sector alone, however, enough to sustain the overall economy? Chen Tai-jy, a National Taiwan University (NTU) economist who informally advises KMT vice presidential candidate Vincent Siew (ref f), also believes

that Taiwan is in the midst of an economic transition, with significant disparities in how different sectors of the economy are adapting. Technology-intensive manufacturing is holding up quite well, he said, even as labor-intensive manufacturing continues to decline. Since the start of the 1990s, Taiwan has shed 431,000 manufacturing jobs, largely in labor-intensive industries such as apparel, footwear, toys, and sporting goods. Service sector jobs, however, have not always offset job losses for less-skilled workers. In Chen's view, the service sector has not been an official priority and is "underperforming." Taiwan's service sector, he noted, traditionally only focused on serving the island's manufacturing industry, and has developed little international competitiveness.

¶6. (C) In fact, significant portions of Taiwan's service sector have not reached their full potential, and have yet to make their full contribution to economic growth. According to TIER's Hong, the service sector, despite accounting for 73 percent of GDP, has "almost no international competitiveness." The financial sector, for example (ref g), suffers from slow regulatory reform, a glut of banks, and persistent low profitability. NTU's Chen singled out tourism as a particular problem, with a performance he described as "ridiculous" when compared with other economies in the region. In 2006, Taiwan's 3.5 million overseas visitors generated \$5.14 billion in revenue, or 1.4 percent of GDP. Corresponding figures for Singapore and Hong Kong are 6.1 percent and 5.5 percent, respectively, although Taiwan does outperform South Korea, where tourism comprised only 0.6 percent of GDP in 2006. Even so, it is far behind other regional tourism powerhouses such as Thailand (6 percent of GDP) and Malaysia (7 percent of GDP).

SOCIAL INEQUALITY

¶7. (SBU) "M-shaped" has emerged as one of Taiwan's leading

TAIPEI 00002545 003.2 OF 004

economic, social - and even political (ref h) - buzzwords to describe a widespread perception that the island's vaunted social homogeneity is unraveling in the face of economic globalization. In fact, Taiwan's Gini coefficient has risen only slightly in recent years, from 0.326 in 2000 to 0.34 in ¶2006. By comparison, similar figures for Hong Kong, Japan, and South Korea are 0.533, 0.308, and 0.310, respectively (NOTE: Japan's figure is from 2004, and South Korea's, which is based only on urban households, is from 2005.) In contrast, the U.S. Gini coefficient was 0.469 in 2006, and China's was 0.47 in 2005. According to TIER's Hong, although per capita GDP is still rising, social inequalities are widening as some groups benefit more quickly than others.

¶8. (SBU) Lackluster wage growth (septel) is dampening consumer confidence and contributing to weak consumption growth. Average annual real per capita income growth declined from 6.9 percent in the 1980s to 5.4 percent in the 1990s and only 2 percent in 2000-2006. Consumer confidence is low, contributing to growth in private consumption of 3 percent in 2006, versus an average of 7.2 percent in the 1990s and 8.4 percent in the 1980s. While these figures may be seen as consistent with Taiwan's progression from a high-growth developing phase to a more mature developed economy, they represent a shock to many Taiwan residents conditioned to decades of rapidly rising living standards.

REGIONAL IMBALANCES

¶9. (SBU) According to official Taiwan household income and expenditure data, income gaps between northern, central, southern, and eastern Taiwan widened from 1996 through 2001, but have since largely narrowed due to expansion of the Tainan and Taichung high-technology industrial parks and the 2004 inauguration of Taiwan's second freeway. In central

Taiwan, average per capita incomes were 17.3 percent below the northern benchmark in 1996, 21.9 percent below in 2001, and 19.4 percent below in 2006. Corresponding figures for the south are 14.9 percent, 25.2 percent, and 23.7 percent, respectively. Contrary to widespread perceptions of a deteriorating north-south income gap, Taiwan's real economic laggard appears to be the relatively isolated and sparsely-populated eastern part of the island, where per capita incomes were 23.5 percent less than the northern level in 1996, with the gap widening to 31.4 percent by 2006. Hualien, the largest city in the east, has seen average per capita incomes drop by 7.58 percent between 2001 and 2006.

¶10. (SBU) Expansion of Taiwan's freeway network appears to have helped mitigate a widening north-south income gap, suggesting that the year-old High Speed Rail (HSR) network linking Taipei with major central and southern cities will also help redress regional imbalances (ref i). Based on TIER analysis, Hong said Taipei and the rest of northern Taiwan would benefit most from the HSR, followed by Kaohsiung and Tainan in the south. Machine tools and some other industrial sectors in Taichung will get a boost from the HSR, he projected, but overall impact on the city will be limited. The HSR will actually have a negative economic impact on other areas of central Taiwan, he added.

CAN TAIWAN MAINTAIN ITS EDGE?

¶11. (SBU) Although challenged by growing competition from China and other developing economies, many Taiwan technology executives appear confident they can maintain their competitive advantage. The CFO of a leading integrated circuit (IC) design firm, for example, recently predicted that Chinese IC design companies will reach technical parity with Taiwan design houses in about five years, but anticipates that Taiwan firms will already have advanced to the next generation of IC technology and continue to expand their market share. This example is a microcosm of Taiwan's larger competitive challenge: constantly develop new

TAIPEI 00002545 004.2 OF 004

technologies and move up the value-added chain, or risk being overtaken by lower-cost competitors. Although not as advanced as regional competitors Singapore and South Korea, Taiwan authorities are now focused on developing its nascent biotechnology sector (septel) as a future engine for economic growth. With U.S. \$4.7 billion in annual biotech value, however, Taiwan is far behind its regional competitors Singapore (\$15.9 billion in 2006) and South Korea (\$7.5 billion in 2005). Currently, Taiwan's biotechnology sector accounts for only 0.6 percent of the global market and amounted to only one percent of the island's total exports in 2006, suggesting Taiwan still has a substantial way to go before the sector plays a significant economic role.

¶12. (SBU) Regardless of concerns about the higher education system, Taiwan remains a potent force in global research and innovation. As a percentage of GDP, Taiwan's research and development (R&D) spending has climbed steadily in recent years, from 1.91 percent in 1998 to 2.52 percent in 2005. Taiwan's R&D spending does not, however, match that of its regional competitors. For example, the corresponding figure for Japan rose from 2.95 percent in 1998 to 3.13 percent in 2004, and in South Korea went from 2.34 percent to 2.85 percent during the same period. Even so, Taiwan's innovation performance has been solid. In 2006, for example, Taiwan ranked fourth in terms of U.S. patents issued, behind the U.S., Japan, and Germany.

WHAT DOES IT MEAN FOR THE U.S.?

¶13. (SBU) With little in the way of natural resources, Taiwan has built a remarkably successful economy. Taiwan's trajectory has been remarkably fast: from a poor,

agricultural economy in 1949 to today's high-technology powerhouse with an annual per capita GDP of over U.S. \$16,000. Perhaps precisely because of the economy's remarkable performance from 1950 until about 2000, Taiwan residents now show a marked impatience and unease with the relative stagnation of recent years. The economy's impressive strengths are mixed with an array of vulnerabilities, as outlined above. At this point, however, perception may be more important than reality for the average Taiwan voter. Both presidential candidates are keenly aware of popular fears that Taiwan's vaunted economic prowess is eroding, and are gauging their campaign platforms accordingly.

¶14. (C) The U.S. economy receives tangible benefits from a vibrant Taiwan, and domestic concerns about economic competitiveness are only likely to underpin concrete reforms beneficial to U.S. interests. The prospect of greater cross-Strait economic integration is the most obvious result, increasing Taiwan's attractiveness as both an investment destination and market for U.S. businesses. In addition, Taiwan's preoccupation with economic performance should drive legal and regulatory reforms beneficial to U.S. interests. The emphasis on economic growth is also likely to maintain Taiwan's rhetorical push for a bilateral FTA as a concrete symbol of U.S. confidence in the Taiwan economy. While an FTA may not be on the table in the immediate future, the U.S. should concentrate on Taiwan's interest in boosting economic growth as leverage for achieving market-opening progress, especially under the Trade and Investment Framework Agreement (TIFA). In particular, there is strong interest among American companies in Taiwan's financial, technology, and other service sectors. Taiwan's increasing focus on attracting foreign investment should also generate greater efforts in further improving IPR protection.

YOUNG